



Appeal of C. Donald and Loretta Frey

Appellant-husband is a medical doctor who specializes in radiology. The bulk of appellants' income during the years under appeal was derived from his medical practice. On January 15, 1965, appellants purchased a one-half acre lemon grove for \$20,900. The former owner was employed to care for the grove 'as a contract-operator. According to appellants, between \$2,000 and \$3,000 was spent to care for the lemon grove during the years 1965-1969. Gross income from the grove decreased from \$397.05 in 1965 to \$102.00 in 1968. Appellants claimed depreciation on the lemon trees for the years 1967 and 1968 based upon the allocation of \$9,000 of the purchase price of \$20,000 to the trees and \$11,000 to the land. However, in 1969, the County of San Bernardino found the grove to be in a "neglected or abandoned condition" and required the removal of the trees. When appellants complied with the order to remove the trees, they claimed an abandonment loss of \$6,589 for the year 1969.

Upon audit, respondent disallowed the deduction claimed for depreciation and abandonment loss of the trees because it did not appear that appellants had purchased the grove with the intention of making a profit. Subsequent to respondent's audit, a federal audit of appellants' return for the same years was conducted. This resulted in the federal disallowance of certain expenses connected with the drilling of four oil wells in 1968 and 1969. Specifically, the Internal Revenue Service found that the promissory notes given by appellants did not represent real and enforceable obligations. In short, it is questionable whether they were ever out of pocket for the expenses claimed.

Respondent issued additional proposed assessments for 1968 and 1969 based upon the results of the federal audit. Appellants protested both the federal and state action. Although the federal matter was apparently concluded in 1975, appellants have never submitted any documentation showing that the federal adjustments were reversed or modified.

The issues presented for determination are the following:

(1) Whether any or all of respondent's proposed assessments are barred by the statute of limitations or by the equitable doctrine of estoppel by laches.

(2) Whether appellants purchased a one-half acre lemon grove in Montclair, California, with the

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intention of making a profit so that depreciation and losses resulting from the eventual abandonment of the trees were properly deductible.

(3) Whether appellants have overcome the presumption of correctness attaching to the federal determination that they were not entitled to deduct various expenses claimed in connection with the drilling of four oil wells in 1968 and 1969.

I. Were The Proposed Assessments Timely or is Respondent Barred by Laches?

Revenue and Taxation Code section 18586 provides that "every notice of a proposed deficiency assessment shall be mailed to the taxpayer within four years after the return was filed." Revenue and Taxation Code section 18588 provides that for the purposes of section 18586, a return shall be considered to have been filed upon the last day prescribed for filing. Under the facts in the instant case, it is clear that all of respondent's proposed assessments were within the prescribed statutory period. Appellants argue, however, that respondent is responsible for a long delay in the processing of this matter and, consequently, the doctrine of equitable estoppel by laches should be applied. We do not agree. The record indicates that the primary cause for delay was the processing of the related federal matter and appellants' failure to advise respondent with respect to the results of the federal proceedings as requested repeatedly.

II. Were Depreciation and Losses Resulting From Abandonment of Trees Properly Deductible?

Revenue and Taxation Code section 17206(a) permits a deduction for losses sustained during the taxable year and not compensated for by insurance or otherwise. Under respondent's regulations, this section limits allowable deductions to **those losses** incurred in a trade or business, or in a transaction entered into for profit. Consequently, appellants are entitled to deductions for depreciation of the lemon grove and for the loss of trees only upon a showing that they operated the grove as a trade or business or as a transaction entered into for profit. In order to prevail, the appellants must establish that they acquired and held the lemon grove primarily for profit-seeking purposes. (Monfore v. U.S., 40 Am. Fed. Tax R.2d 77-5347; Harold I. Snyder, ¶ 66,259 P-H Memo. T.C. (1966); Bertha R. Conyngham, ¶ 64,194 P-H Memo. T.C. (1964);

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Lamont v. Commissioner, 339 F.2d 377 (2nd Cir. 1964).) Respondent maintains that appellants' claim to having purchased the grove with the intention of making a profit is inconsistent with all of the available objective evidence. Such evidence includes facts such as: (1) appellants' major source of income was from appellant-husband's medical practice and admittedly appellant-husband had neither the time nor the expertise to become personally involved in the cultivation of the grove; (2) the production of minimal income from the lemon grove; (3) the limited size of the grove; (4) no efforts were made by appellants to reverse the trend of declining sales; and (5) appellants allowed the grove to go into a state of neglect causing the county to issue a notice to abate order. In view of this evidence, the case of In Re Drage, 42 Am. Fed. Tax R. 2d 78-5869 (1978) appears to be analogous to the instant matter. In that case, the court denied the deductions and held that the taxpayer, inexperienced in citrus farming, had not appeared to make a substantial effort to improve the profitability of his grove.

We agree with respondent that the appellants here, as in Drage, have not carried the requisite burden of proving that they intended to make a profit from operating the grove. Therefore, respondent was correct in finding that no profit motive existed in this case and properly disallowed the claimed deductions.

III. Have Appellants Overcome the Presumption of Correctness Attaching to the Federal Determination that They Were Not Entitled to Deduct Claimed Expenses?

Revenue and Taxation Code section 18451 provides that, in the case of a federal adjustment, the taxpayer must either concede the accuracy thereof or demonstrate wherein it is erroneous. (Todd v. McColgan, 89 Cal. App. 2d 509 [201 P.2d 414] (1949); Appeal of Willard D. and Esther J. Schoellerman, Cal. St. Bd. of Equal., Sept. 17, 1973; Appeal of Joseph B. and Cora Morris, Cal. St. Bd. of Equal., Dec. 13, 1971.) Respondent's regulations presume the adjustment to be correct, and the burden is placed upon the taxpayer of affirmatively overcoming the presumption in order to prevail. Here, the Internal Revenue Service's finding that promissory notes paid by appellants did not represent real and enforceable obligations has not been shown by appellants to be erroneous. The only cases cited by appellants in support of their Position involve theft losses, e.g., Perry A. Nichols, 43 T.C. 842 (1965). However, if appellants wish to claim a theft loss, they must prove the elements of theft, and

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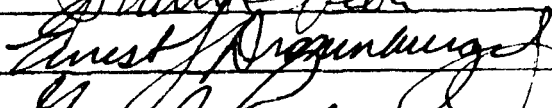

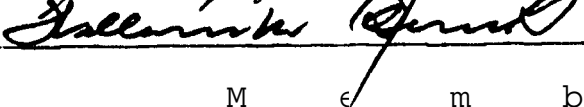
that a loss actually occurred. There is an allegation by appellants that their notes relative to the oil drilling venture were sold to third parties, and consequently they paid \$2,700 to Security Pacific Bank in an out of court settlement and \$800 relative to certain drilling leases. We have no further verification of this allegation. They also allude to certain unspecified federal class action suits which are pending. Aside from these vagaries, appellants have offered no evidence showing an alteration of the federal adjustments, nor any documentation tending to support their position that the claimed deductions were improperly disallowed. Therefore, the information before us simply does not justify any adjustment in respondent's determination.

O R D E R

Pursuant to the views expressed in the opinion of the board on file in this proceeding, and good cause appearing therefor,

IT IS HEREBY ORDERED, ADJUDGED AND DECREED, pursuant to section 18595 of the Revenue and Taxation Code, that the action of the Franchise Tax Board on the protest of C. Donald and Loretta Frey against proposed assessments of additional personal income tax in the amounts of \$58.00, \$416.38, \$32.04, \$3'38.06 and \$353.02 for the years 1967, 1968, 1968, 1969 and 1969, respectively, be and the same is hereby sustained.

Done at Sacramento, California, this 21st day
of May , 1980, by the State Board of Equalization.


_____, Chairman

_____, Member

_____, Member

_____, Member
_____, M e m b e r